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**7535-01-U**

## **NATIONAL CREDIT UNION ADMINISTRATION**

### **12 CFR Part 712**

#### **Audit Requirement for Credit Union Service Organizations**

**AGENCY:** National Credit Union Administration (NCUA)

**ACTION:** Final rule.

**SUMMARY:** NCUA is amending its rule concerning credit union service organizations (CUSOs) to provide that a wholly owned CUSO need not obtain its own annual financial statement audit from a certified public accountant if it is included in the annual consolidated audit of the federal credit union (FCU) that is its parent. The amendment will reduce regulatory burden and conform the regulation with agency practice, which since 1997 has been to view credit unions with wholly owned CUSOs in compliance with the rule if the parent FCU has obtained an annual financial statement audit on a consolidated basis.

**DATES:** This rule is effective on [INSERT DATE THIRTY DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER].

**FOR FURTHER INFORMATION CONTACT:** Ross P. Kendall, Staff Attorney, Office of General Counsel, at telephone (703) 518-6540.

**SUPPLEMENTARY INFORMATION:**

**Background**

On March 17, 2005, the NCUA Board requested comment on a proposed change to part 712 of its regulations to provide that that a CUSO that is wholly owned need not secure its own public accounting firm financial statement audit if it is included on a consolidated basis in the audit of the FCU itself. 70 FR 14579 (March 23, 2005). The proposal recognized that, where a CUSO is controlled by an FCU by virtue of its ownership of one hundred percent of its voting shares, generally accepted accounting principles (GAAP) call for the preparation of financial statements of both the FCU and the CUSO on a consolidated basis.

As noted in the preamble to the proposed rule, consolidated financial statements present the results of operations, financial position, and cash flows of a parent and its subsidiaries as if the group were a single enterprise. Under GAAP, consolidated financial statements generally include enterprises in which the parent has a controlling financial interest, usually, a majority voting interest. There is a presumption that

consolidated statements are more meaningful than separate statements and are usually necessary for a fair presentation when one of the enterprises in a group directly or indirectly has a controlling financial interest in another.

### **Summary of Comments**

NCUA received twelve comments on the proposal, eleven of which were fully supportive of the amendment. These commenters noted several bases for their support, including efficiency, flexibility and cost savings, as well as the generally more thorough and accurate financial picture that emerges when the operations of corporate parents and subsidiaries are included in a consolidated financial statement. The one commenter that did not offer express support did not indicate opposition to the proposal, but rather raised two questions about the operation of the rule in specified circumstances.

In the preamble to the proposed rule, the Board specifically recognized that GAAP would allow for consolidated financial reporting in cases that involve a CUSO that is majority owned. The Board noted, however, that it was not recommending extension of the rule to those cases, and indicated its belief that the proposal would ensure that prospective minority investors in CUSOs would have maximum disclosure of potential risks to their investment. Nine commenters recommended that NCUA extend the exemption for a separate audit to majority owned CUSOs, instead of limiting it to cases of one hundred percent ownership. Two of these commenters conditioned their support for this expanded treatment on including in the rule a safeguard to allow a minority owner to request the CUSO to obtain a separate opinion audit.

The Board remains convinced that the original proposal, with its limited application only to cases involving one hundred percent ownership of the CUSO, is the best course. Absent a provision in the rule, a minority investor could encounter some difficulty in asserting its right to a separate opinion audit. The Board notes, in this respect, that its concern for the safety and soundness of credit unions, rather than assuring that its rules conform in all respects to what may be formally permissible under GAAP, is of paramount importance. Accordingly, NCUA is adopting the proposed amendments as a final rule without change.

The Board notes that the rule change extends to cases involving CUSO subsidiaries that are also wholly owned. While cases of second tier CUSOs are relatively rare, the principles of the rule would apply. Thus, where the second tier CUSO is itself wholly owned by a wholly owned first tier CUSO, use of a consolidated opinion audit capturing both levels would be permissible.

## **REGULATORY PROCEDURES**

### Regulatory Flexibility Act

The final rule relieves a CUSO that is wholly owned from having to secure a separate opinion audit of its books, if it is included in the annual consolidated opinion audit of the credit union that is its parent. The Board has determined and certifies that the rule will

not have a significant economic impact on a substantial number of small credit unions. Accordingly, the NCUA Board has determined that a Regulatory Flexibility Analysis is not required.

#### Paperwork Reduction Act

NCUA has determined that the proposed regulation does not increase paperwork requirements under the Paperwork Reduction Act of 1995 and regulations of the Office of Management and Budget.

#### Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on state and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. The final rule will apply only to federally-chartered credit unions. It will not have substantial direct effects on the states, on the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined that this proposal does not constitute a policy that has federalism implications for purposes of the executive order.

The Treasury and General Government Appropriations Act, 1999 - - Assessment of  
Federal Regulations and Policies on Families

The NCUA has determined that the final rule will not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105-277, 112 Stat. 2681 (1998).

Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104-121) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by Section 551 of the Administrative Procedure Act. 5 U.S.C. 551. The Office of Management and Budget has determined that this rule is not a major rule for purposes of the Small Business Regulatory Enforcement Fairness Act of 1996.

**List of Subjects in 12 CFR Part 712**

Administrative practices and procedure, Credit, Credit unions, Investments, Reporting and record keeping requirements.

By the National Credit Union Administration Board on September 15, 2005.

Mary F. Rupp  
Secretary of the Board

For the reasons stated in the preamble, NCUA amends 12 CFR part 712 as follows:

**Part 712 - CREDIT UNION SERVICE ORGANIZATIONS (CUSOs)**

1. The authority citation for part 712 continues to read as follows:

**Authority:** 12 U.S.C. 1756, 1757(5)(D), and (7)(I), 1766, 1782, 1784, 1785 and 1786.

2. Amend §712.3 by revising paragraph (d)(2) to read as follows:

**§712.3 What are the characteristics of and what requirements apply to CUSOs?**

\* \* \* \* \*

(d) \* \* \*

(2) Prepare quarterly financial statements and obtain an annual financial statement audit of its financial statements by a licensed certified public accountant in accordance with generally accepted auditing standards. A wholly owned CUSO is not required to obtain a separate annual financial statement audit if it is included in the annual consolidated financial statement audit of the credit union that is its parent; and

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